

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF)	
CHESAPEAKE UTILITIES CORPORATION FOR)	
APPROVAL OF NATURAL GAS EXPANSION)	PSC DOCKET NO. 12-292
SERVICE OFFERINGS)	
(FILED JUNE 25, 2012))	

Comments from the Delaware Public Service Commission Staff regarding Chesapeake Utilities Corporation's application requesting approval of natural gas expansion service offerings in Eastern Sussex County.

Dated: November 30, 2012

APPLICATION

On June 25, 2012, Chesapeake Utilities Corporation ("Chesapeake" or the "Company") filed with the Delaware Public Service Commission (the "Commission") an application (the "Application") seeking approval of various natural gas expansion service offerings that, according to Chesapeake, would enable it to extend its natural gas distribution facilities in eastern Sussex County more efficiently than would otherwise be practical under the Company's current tariff provisions.

The proposed expansion service offerings provide for higher rates in the designated expansion area and modified line extension policies because, according to Chesapeake, under existing rates and line extension policies, service cannot be provided to many customers without the customer paying a substantial up-front contribution or advance.

The proposed expansion service offerings include:

1. A new Infrastructure Expansion Service ("IES") Rate, applicable only to customers within the proposed expansion area.
 - a. \$8.00 per month for Expansion Area Residential Service – 1.
 - b. \$25.00 per month for Expansion Area Residential Service – 2.
 - c. \$40.00 per month for the Expansion Area General Service
 - d. \$125.00 per month for Expansion Area Medium Volume Service.
2. A new Distribution Expansion Service ("DES") Rate, applicable to all customers, at \$1.25 per month.
3. Tariff changes relating to main extensions and the economic analysis of customer additions for existing residential developments. The Company is currently using the six times net-revenue test for existing developments and is proposing using the Internal Rate of Return Model ("IRRM") for new and existing developments. The Company believes the six times net-revenue test does not provide an accurate measure when it comes to expanding service to existing developments.
4. Tariff changes proposing to eliminate provisions that require the Company to provide installation up to 75 feet of service line from existing distribution mains and 100 feet for main extension lines.
5. A new Conversion Finance Service option to provide financing for new customers who wish to convert from another fuel to natural gas and
6. A new Conversion Management Service option to assist with coordination of the conversion work.

BRIEF BACKGROUND

On July 3, 2012, the Commission issued Order No. 8174 which suspended the rates and revised tariff sheets filed by the Company, directed the Company to issue a public notice regarding the matter, assigned the matter to Hearing Examiner Mark Lawrence, and set a deadline for filing petitions to intervene by August 10, 2012. Intervention petitions were granted by the Hearing Examiner for Division of Public Advocate ("DPA"), Department of Natural

Resources and Environmental Control ("DNREC"), Delaware Association of Alternative Energy Providers, Inc. ("DAAEP"), Delmarva Power & Light Company ("Delmarva" or "DP&L"), Caesar Rodney Institute ("CRI").

With approval from Hearing Examiner Lawrence, the parties circulated informal discovery in July and September 2012 to the Company regarding the application and the development of the rates. A Pre-Hearing Conference was scheduled for September 27, 2012; however the Company advised due to its limited available personnel it would be unable to completely respond to its entire informal discovery requests prior to this date and asked to lengthen the informal discovery period. As a result, the parties met for a Pre-Hearing Conference on October 15, 2012 to discuss the application in further detail and to seek clarification from the Company on informal discovery which had been circulated prior to this meeting. At this meeting it was agreed to by all of the parties that some additional discovery would be asked and that the parties would hold a conference call on November 19, 2012 to clarify and follow up on any additional discovery which was circulated after the initial pre-hearing conference. The parties also additionally agreed to issue by November 30, 2012 position papers regarding their respective positions on all or parts of the filing. Finally, the parties scheduled a Workshop to be held on December 10, 2012 to be able to discuss the various position papers circulated among the parties.

**PSC STAFF COMMENTS REGARDING
SPECIFIC AREAS OF THE APPLICATION**

Infrastructure Expansion Service ("IES") Rate

The Company is proposing the IES for customers only within the proposed expansion area. This fee would be built in to the existing customer charge and depending on the customer class could be an additional \$8, \$25, \$40, or \$125.

Staff has concerns regarding the approval of a proposed IES rate and in how these proposed rates were calculated in their respective rate classes. There appears to be a variety of variables involved in how these figures were calculated with a number of important questions raised by Staff as outlined in the discovery requested from the Company.

The proposed expansion area contains a number of homeowners who may be considered seasonal residents. It would appear that the Company has assumed the majority of these homeowners would be classified in the "Expansion Area Residential Service – 2" category however there is concern that the Company has underestimated the amount of seasonal homeowners due to the uniqueness of this service territory who may end up being classified in the "Expansion Area Residential Service –1" category. If true, this would significantly impact the forecasts proposed by the Company.

This issue also ties into concerns regarding the forecasted annual usage of Mcf per customer in the proposed rate classes. The potential usage associated with a partial year dwelling could be significantly reduced or eliminated during a winter heating season, which again would significantly impact the forecasts proposed by the Company.

Additionally, there has been little discussion in regards to how long this proposed rate would remain in effect should it be approved by the Commission. Once the infrastructure into the proposed expansion area has been installed and a majority of anticipated conversions completed, would this rate simply remain in effect? Should customers who happen to be located in what the Company deems an expansion area continue to pay additional costs than what current customers are paying when they are receiving essentially the same service?

At this time, Staff has significant reservations regarding the supporting documentation provided for the development of the IES rate and cannot support the implementation of an IES rate to customers in the proposed expansion area. The Company has not provided cost justification for how the IES rate for each customer class was determined other than the cost differential between propane and natural gas. The Company has stated the costs will be different for each development that desires to have natural gas; however they have not suggested a different IES rate based on the actual costs for each development. Is the IES rate truly representative of the cost to serve new customers in this part of Sussex County or more reflective of the potential value of such service?

The Company expects to collect \$5,256,764 in IES rates from 2013-2017; yet no cost of service study was done to determine if the amount is adequate or necessary. Staff feels that it would be more appropriate to include this proposed rate in the Company's next base rate filing as part of an overall cost of service study which can be reviewed in the context of the Company's overall rate design.

Distribution Expansion Service ("DES") Rate

The Company is proposing the implementation of a DES rate applicable for all its customers. This rate would add an additional \$1.25 per month, or \$15 per year, to a customer's bill reflected in the Customer Charge.

Similar to Staff's position on the IES rate, Staff has concerns regarding the approval of a proposed DES rate and in how this figure was calculated. Since the DES rate is applicable to all existing customers, this rate would result in approximately \$622,500 of additional revenue annually. These existing customers would not utilize the additional services proposed in this filing. The Company has also stated that elimination or reduction in the proposed DES rate would decrease their ability to respond to demand in the expansion area. This would suggest that the expansion is not economically feasible without monetary contribution from the entire customer base.

Based on the information received from the Company in informal discovery, Staff also has significant concerns with the supporting documentation provided for the development of the DES rate and cannot support the implementation of a DES rate to all of Chesapeake's customers. The Company has not provided justification for how the \$1.25 increase was determined other than declining usage from 2007 until 2012. For three of the last six quarters the Company has seen its unadjusted ROR close to or slightly exceeding its authorized ROR in the last base rate case. The Customer Charge is typically adjusted in general base rate cases after the completion

of a cost of service study. The Company has stated it does not anticipate filing for a base rate case in the next twelve months. A base rate case is the proper way to recoup losses resulting from a reduction in customer usage.

Tariff Changes regarding Main Extension Modifications

The Company is proposing a modification Section VI of its tariff relating to its Service Installations and Main Extensions policies. Currently, the Company will install up to 75 feet of service line from an existing distribution main to the Customer's meter location and extensions of up to 100 feet of existing mains per Customer. Additionally, the Company currently uses the six times net-revenue test to determine whether or not it is economically feasible to expand service to an existing development. The Company wishes to modify the tariff to remove the installation requirement of 75 feet of service line and instead use the six-times net revenue test for the entire service installation. The Company is also seeking to use the Internal Rate of Return Model ("IRRM") to test economic feasibility for new and existing developments as the Company believes the six times net-revenue test does not provide for an accurate measurement when it comes to expanding service to existing developments.

While much of the parties discussion of this application has focused on the proposed IES and DES rates, there has been limited discussion or support offered regarding why the Company feels the six times net-revenue test no longer is the most appropriate measure. The Company's only justification offered is that they prefer the IRRM model as it has the capability of assessing a project with multiple build-out years.

It would be preferable if scenarios had been provided illustrating the reasoning behind this request. If a clearer understanding had been provided as to why the Company needs to have this change, coupled with an explanation of how it would negatively impact its ability to do business if it was not approved, Staff might be able to support the Company's request given that the IRRM model has already been approved by the Commission for new development with more than 500 feet of main extension.

If changes were made to the current Main Extensions tariff rules, Staff would have concerns regarding the calculation of customer contributions to extensions specifically in existing developments with seasonal home owners. Staff believes that seasonal customers contribution to extensions is not comparable to that of year round customers, yet the cost to extend service to a dwelling would be the same.

Conversion Finance Service & Conversion Management Service

The Company is proposing two new optional services. A conversion finance service would be available to assist interested residential and smaller commercial customers with the cost of converting their existing equipment and internal fuel piping so as to make the same compatible with natural gas. This service would provide a maximum amount of \$1,500 for residential customers and a maximum amount of \$3,000 for commercial customers repayable to the company in either a three, five, or ten year term. This term would be selected by the customer. If the customer desired to have the Company assist them during the conversion

process, the Company would assist the customer with locating a Company approved contractor to assist with general coordination of the conversion. At the completion of the conversion process the Company would assess a Conversion Management Fee of \$100.00.

At this time Staff believes that the Company does not have adequate documentation to support the optional Conversion Finance Service that Chesapeake as proposed. There is no detailed analysis of how the maximum level of assistance of \$1,500 for residential and \$3,000 commercial was calculated and the probability that the conversion costs would fall below these maximum levels. Chesapeake is not in the business of financing and therefore Staff believes that it should not venture into the business of lending money to its customers. Chesapeake is also placing additional risk on its customers should the Company see its uncollectibles increase due to this proposed in-house financing program. Staff believes that utilities should keep their focus on providing safe, reliable, and adequate service to its customers. Chesapeake also stated that it is uncertain the exact level of administrative costs that will be necessary for this program, but estimates that it may be less than \$25,000. Staff has concerns about the level of complaints that may arise if such a program is put in-house, which in turn would increase not only internal administrative costs but possibly PSC monitoring costs as well.. At this time, Staff believes that there is not enough analysis to support this program.

The optional Conversion Management Service fee for assisting the customer in managing and coordinating the conversion process with outside contractors appears adequate to cover the cost of providing the service based on the assumptions given by the Company. However, in regards to the Conversion Management Service one-time fee of \$100, the Company has not yet determined how long this service will be offered to its customers nor provided any documentation of market interest information in the program.

Energy Efficiency Resource Standards

Staff believes this proposal has positive environmental impacts and supports recommendations made by the State of Delaware Energy Efficiency Resource Standards ("EERS") workgroup. The EERS workgroup report stated, "...the Workgroup supports the expansion of gas service in all areas of the state and recommends inclusion of fuel switching and gas fired heat and power (CHP) towards energy efficiency savings." Through discovery, the Company stated that it views the EERS workgroup report as a mandate to expand its natural gas offerings, and estimates that if the expansion reached 5,682 customers over a five year period, the environmental impact would be the equivalent of taking approximately 537 vehicles off the road. However, the positive environmental impacts do not outweigh the concerns Staff has highlighted.

CONCLUSION

The Company proposes an IES rate which potentially could collect \$5,256,764 from 2013-2017 with no cost of service study to determine if the amount is adequate or necessary. In addition to the IES, the proposed DES rate would result in approximately \$622,500 of additional revenue annually. The proposed modifications to the Main Extension tariff will reduce the obligations the Company currently has to install service lines. The proposed conversion finance

service has the potential to increase bad debt expense, which if incurred would ultimately shift to the Company's ratepayers through higher rates. The risk for recovery of infrastructure associated with extensions would also be risk shifted to all ratepayers as part of a future base rate proceeding should build out and or payback not occur as estimated by the Company.

Staff would suggest that the Company start its expansion effort on a smaller scale utilizing the Experimental Area Extension Program ("AEP") provisions outlined in the Company's existing tariff. The AEP provisions have not been utilized since becoming effective in 2008. If the proposed rate schedules were to be implemented, Staff would have concerns with ratepayer subsidization. Specifically, as this expansion effort appears to be partly funded using money collected from the entire customer base suggesting expansion is not feasible without a contribution from the entire customer base.

With the uncertainty of how these rates were developed, no proposed time line of how long these proposed rates would remain in effect and no cost of service study completed to determine whether or not the amounts are adequate or necessary, Staff cannot support placing all the inherent risks associated with this proposal on ratepayers. Staff feels that it would be more appropriate to include these proposed rates in the Company's next base rate filing as part of an overall cost of service study, which can be reviewed in the context of the Company's overall rate of return and rate design, and would allow for consideration of other funding sources such as long term debt.